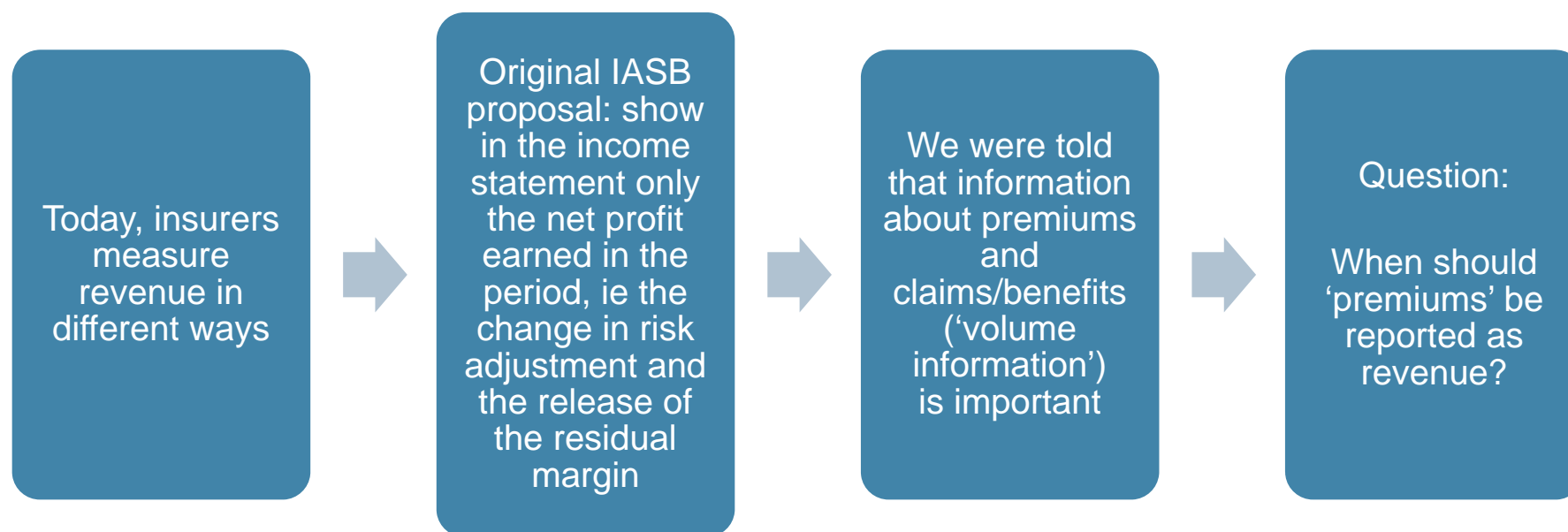


Insurance contracts: An introduction to agenda paper 2A/90A

Premiums earned, due or written?

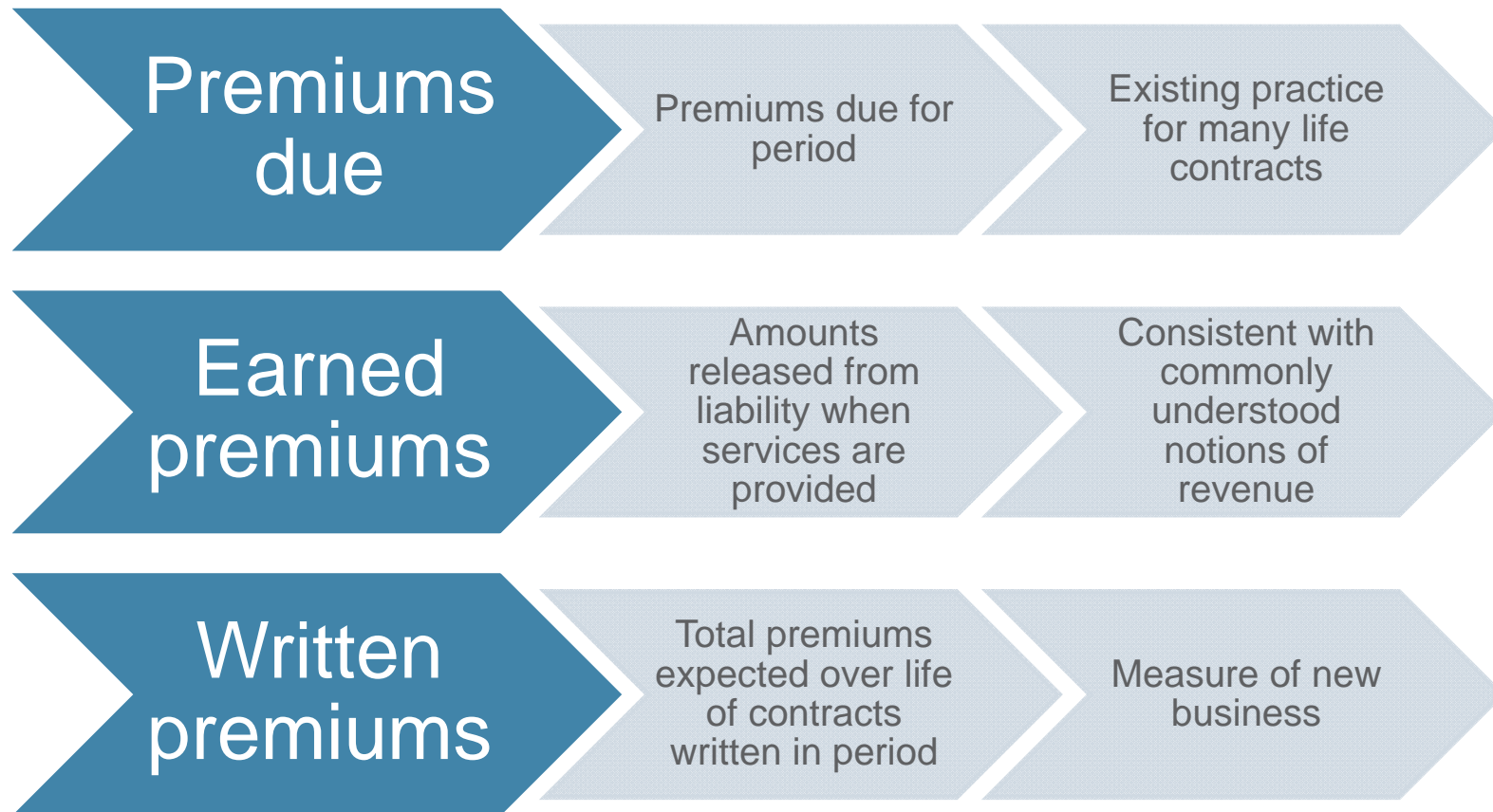
IASB Education Session

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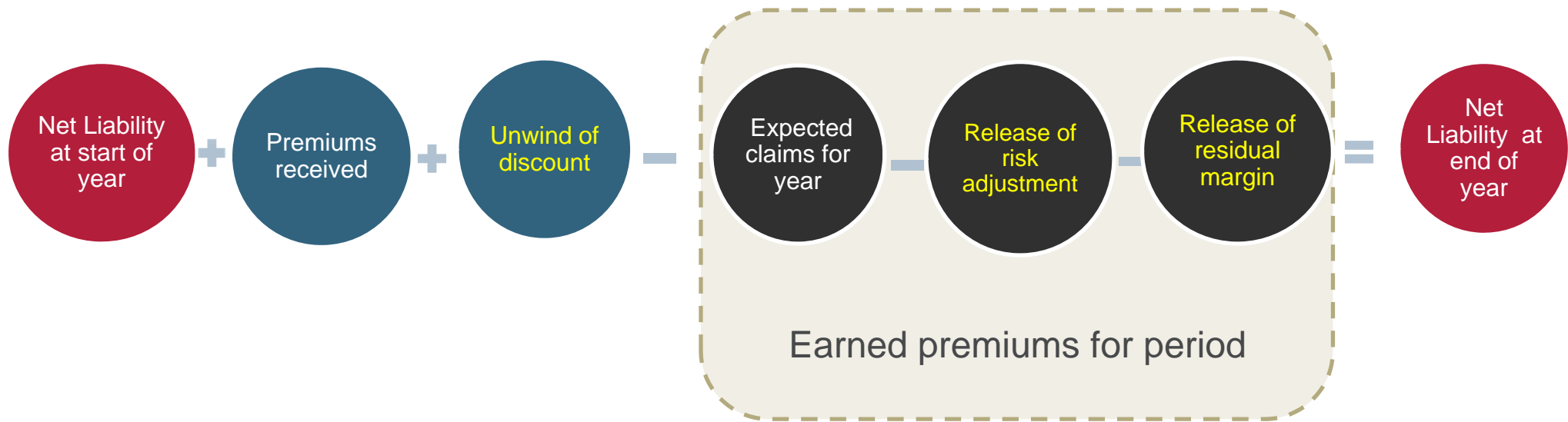


- Present premiums and claims in income statement
- Exclude ‘investment component’ from premiums and claims
 - Amount insurer is obliged to pay policyholder or beneficiary regardless of whether insured event occurs.
- October meeting – plan to discuss allocation of premiums between periods

Methods of allocating premiums



Earned premiums – derived from measurement model



Expected claims = actual claims ± **experience adjustments**

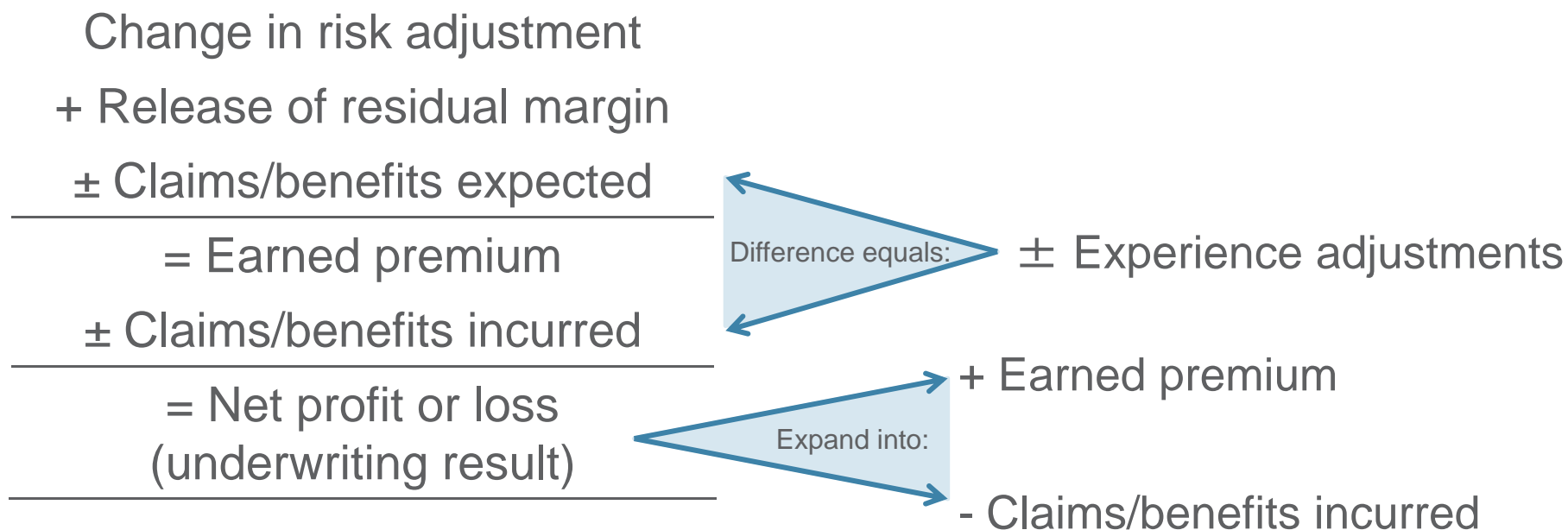
Proposed measurement model determines profit or loss from insurance contracts

$$\begin{aligned} & \text{Change in risk adjustment} \\ & + \text{Release of residual margin} \\ & \pm \text{Experience adjustments} \\ \hline & = \text{Net profit or loss (underwriting result)} \end{aligned}$$

Experience adjustments
= claims/benefits expected
– claims/benefits incurred

Original proposal was to show in the income statement only the net profit or loss earned in the period

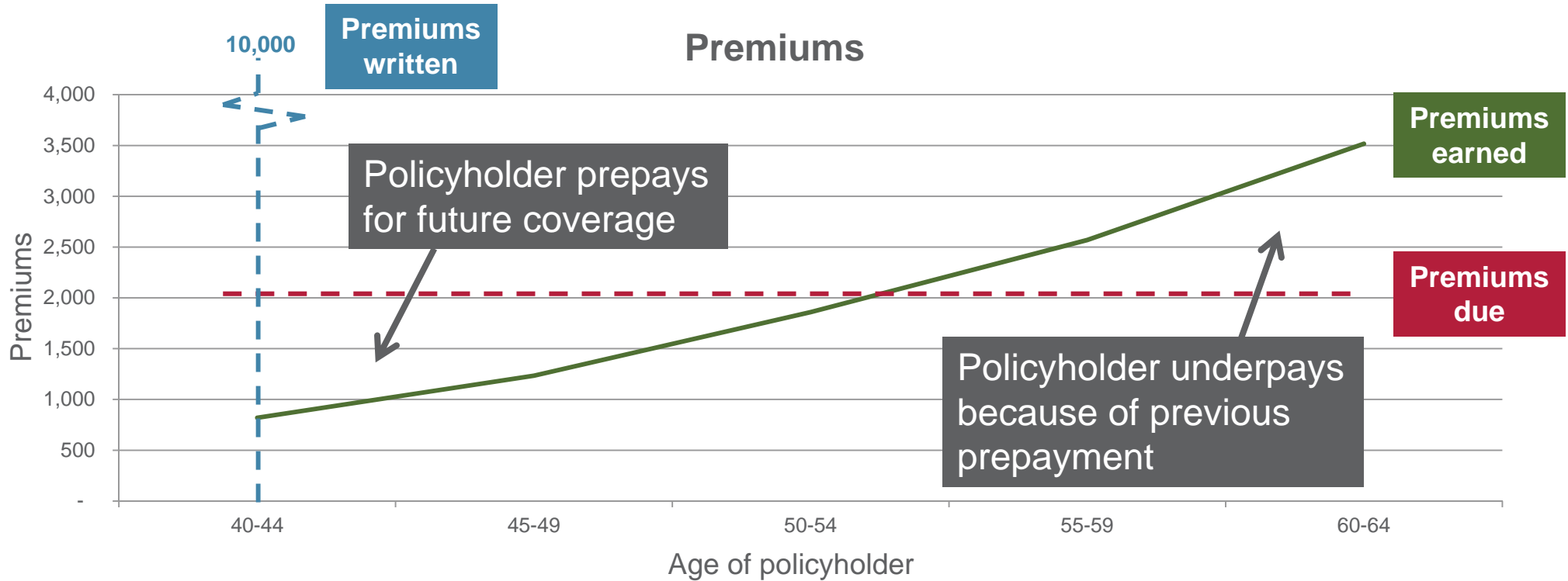
Expanding net profit and loss to show claims/benefits incurred



Earned premium:

- Consistent with concept of revenue
- Consistent with measurement model for insurance contracts

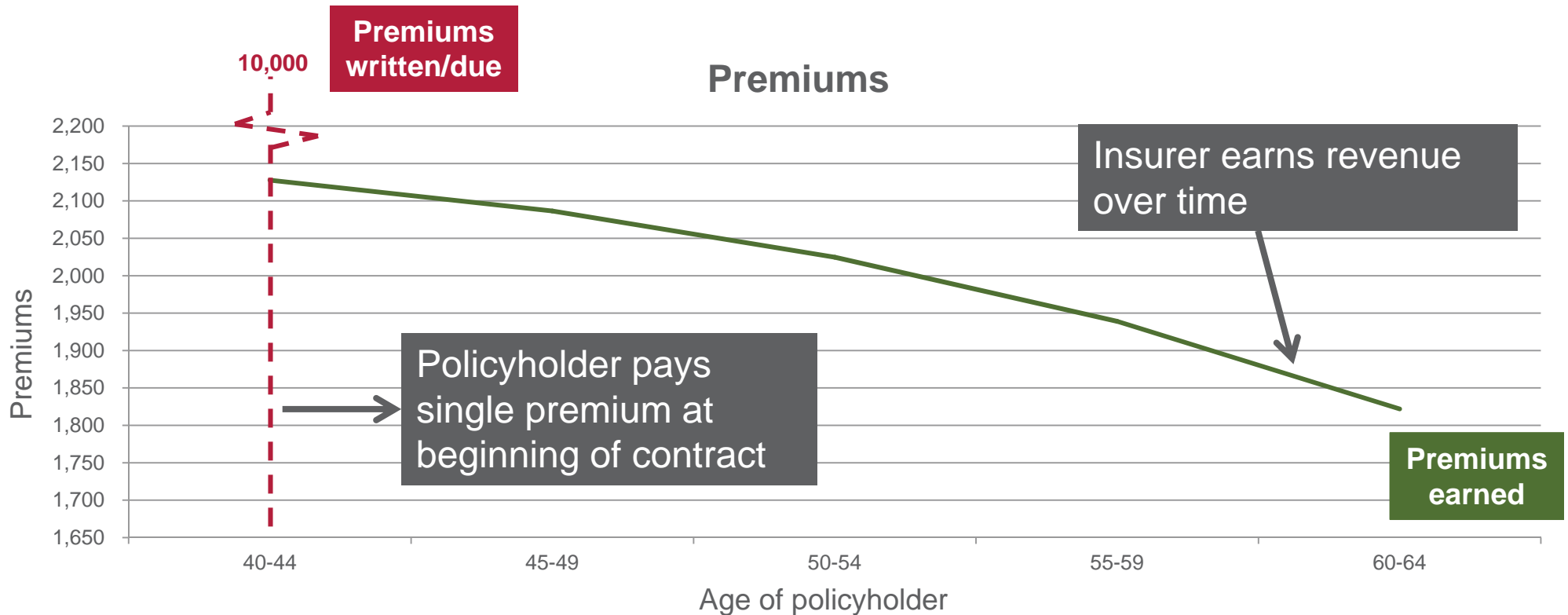
When should premiums be reported as revenue? Level premium term life contract



- Assumptions:
 - Portfolio of term life contracts issued to 40 year olds
 - Expected claims/benefits are 10,000; premiums are due 2,000 each 5 year period
 - Ignores premiums “allocated” to the margins, payment of acquisition costs, and payment of maintenance and benefits expense
 - Assumes no lapses, no discounting, and no investment component



When should premiums be reported as revenue? Single premium annuity contract



- Assumptions:
 - Portfolio of immediate annuity contracts issued to 40 year olds
 - Expected claims/benefits is 10,000
 - Ignores premiums “allocated” to the margins, payment of acquisition costs, and payment of maintenance and benefits expense
 - Assumes no lapses, no discounting, and no investment component



Introducing an example: A simple fact pattern

	Period 1	Period 2	Period 3	Total
Cash inflows (premiums)	800	400	0	1200
Cash outflows (claims/benefits)	-200	-350	-500	-1050
Cash flows that arise in fulfilling contract	600	50	-500	150
Change in risk adjustment	32	30	28	90
Release of residual margin	23	19	18	60
Net profit or loss (underwriting result)	55	49	46	150

Disclosure reconciling movements in year required for all approaches

	Period 1	Period 2	Period 3
Liability at start of period	-	545	546
Premiums received	800	400	-
Claims/benefits paid	-200	-350	-500
Experience adjustments	Assumed none		
Change in risk adjustment	-32	-30	-28
Release of residual margin	-23	-19	-18
Change in discount rate	Assumed none		
Liability at end of period	545	546	-

Information about cash received and cash paid will be provided in the notes



Example: earned premium presentation

	Period 1	Period 2	Period 3	Total
Earned premium	255	399	546	1200
Claims/benefits	-200	-350	-500	-1050
Profit or loss (underwriting result)	55	49	46	150
<i>Reconciliation of underwriting result (disclosures)</i>				
	Period 1	Period 2	Period 3	Total
Change in risk adjustment	32	30	28	90
Release of residual margin	23	19	18	60
	55	49	46	150

Recognised when earned (equals the sum of expected claims/benefits, change in risk adjustment and release of residual margin)

Recognised when incurred



Example: Premiums due presentation

	Period 1	Period 2	Period 3	Total
Premiums due	800	400	0	1200
Claims/benefits incurred	-200	-350	-500	-1050
Change in liability	-545	-1	546	-
Profit or loss (underwriting result)	55	49	46	150

Recognised when due

Recognised when incurred

Balancing figure

The 'change in liability' line can be expanded to show component parts as is shown on the next slide.

Example: Premiums due presentation expanded to show component parts

	Period 1	Period 2	Period 3	Total
Premiums due	800	400	0	1200
Claims/benefits*	-700	-350	0	-1050
Change in risk adjustment				
Increase in risk adjustment	-60	-30	0	-90
Release of risk adjustment	32	30	28	90
Change in residual margin				
Increase in residual margin	-40	-20	0	-60
Release of residual margin	23	19	18	60
Profit or loss (underwriting result)	55	49	46	150

Change in liability less change in risk adjustment and release of residual margin allocated to these lines

Premiums recognised when due

*Claims/benefits incurred plus future amounts relating to premiums due

Earned premiums – the SCl in detail

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Insurance contract revenue	X
Claims and benefits incurred	- X
Expenses	- X
Amortisation of acquisition costs	- X
Changes in estimates of future claims, benefits and expenses (if recognised immediately in profit or loss).	- X
Unwind of previous changes in estimates	X
Losses on initial recognition of insurance contracts	- X
Unwind of previous losses on initial recognition of insurance contracts	X
Gross underwriting margin	X
Investment income	X
Interest accreted on insurance contract liability	- X
Profit	X
Components of other comprehensive income	± X
Total comprehensive income	X

Feedback from discussions with users

Volume information useful to assess growth.

Need information analysed by product type, including investment component.

BUT would not expect to find in income statement.

Relatively little use made of headline premiums due.

Important to disaggregate investment component

Premium due simple and tangible

Specialist users most interested in sources of profit

Generalist users perhaps more interested in consistency with other industries

Earned premium better measure of risk covered in period